

Short and Long Side Alpha in the Tech Space

Stockholm (HedgeNordic) – Four Norwegians running one of the best performing long-only equity funds of the last decade also manage a market-neutral version of the same fund. **DNB TMT Absolute Return**, maintaining a close to zero beta portfolio of stocks in the global telecom, media, and technology sectors, aims to capture alpha regardless of where equity markets are headed.

DNB TMT Absolute Return and DNB Technology Fund, a long-only fund that delivered an annualized return of around 24 percent in the past ten years, are both managed by Anders Tandberg-Johansen alongside Sverre Bergland, Erling Thune, and Erling Kise. HedgeNordic got the chance to sit down with the team during their short trip to Stockholm and discuss their market-neutral strategy.

Relative-Value Strategy in the Technology Space

DNB TMT Absolute Return maintains a portfolio of 30 to 50 long positions and a similar number of short positions from a universe that accounts for one-fourth of all global equity markets. Anders Tandberg-Johansen, who has been working in the technology area for around 20 years, tells HedgeNordic that “we have been working in this space for a very long time; at this point, we know almost all the universe.”

The market-neutral strategy involves going long and short on pairs of competing companies in the TMT sector based on their relative valuations and momentum. As Sverre Bergland explains, “we are only interested in the relative valuations between different stocks in our universe, because that’s where we extract excess returns.” The investment approach, therefore, relies heavily on active management. “Many names in our portfolio are not changed over time, but we trade around our positions very frequently because security prices change more than the underlying values of companies,” explains Johansen.

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To identify portfolio constituents, the four-member team relies on price-based screening followed by a more extensive fundamentals-based analysis. “The screening process typically starts with price screening, and then we do deeper work on attractive investment candidates,” explains Johansen. “Obviously we know most industries in this space and companies in particular, and we look upon more thoroughly when we see an opportunity on a relative basis.”

“We are very price-focused,” admits Johansen, but the team focuses on the valuation of companies relative to their value creation potential. To determine the value creation potential of a company, “we evaluate if the board is good, examine if there are the right incentives for the management in place, and obviously, we assess whether companies have the potential to scale up operations.” Nonetheless, price is the ultimate decision factor on whether to buy or sell a stock. “We could invest in companies with bad management teams if the price is low enough,” acknowledges Johansen.

Cheap or Expensive? Security Selection Process

To determine whether something is cheap or expensive, “we use different valuation metrics given the situation,” says Johansen. According to the team, different sub-segments in the TMT sectors warrant different multiples. “We use adjusted earnings, which are more like cash flow earnings” as

one of the primary metrics. "For cyclical companies, however, we may look at price to book valuation metrics, particularly when things are tough and there are no earnings."

Anders Tandberg-Johansen and the team use a mistake discovery mechanism to run DNB TMT Absolute Return. "In both our long fund and the market-neutral fund, we have seen that we are right in our buy and sell decisions about 55 - 60 percent of the time," admits Johansen. "We monitor all companies very close, go through their earnings transcripts, and meet with the management teams to identify if there is anything wrong in our long-term thesis." These mistakes can usually be spotted on short-term data points. "This is not price-momentum, it's fundamental momentum," says Johansen.

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The team is eager to sell positions when more attractive risk-reward opportunities pop up in the market. "When there is an opportunity on the outside [of the existing portfolio] that is showing up as more attractive, we might take out the weakest relative-value ideas," states Johansen. The portfolio managers run different levels of conviction and thereby different bet sizes. "Typically, the top 20 positions, the top ten long and the ten short positions, account for around 50 percent of the risk, but then we maintain a lot of smaller bets in the portfolio," he adds.

Alpha on the Long and Short Side

The team running DNB TMT Absolute Return performs pure stock picking both in the long and in the short leg, aiming to construct a portfolio that is as close to zero-beta as possible. "In the market-neutral fund, we are not taking any market bets," says Johansen. This represents an appealing feature for most investors looking for uncorrelated strategies in the current market environment. "Many people like our fund because of our uncorrelated returns and because we are truly market neutral," he adds.

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"A common discussion in the market is that investors face difficulties in finding places where to invest: property markets have been on a high note, equity markets have also been on a high note," says Johansen. Alternative investment products such as hedge funds are a source of potential returns, he acknowledges. "And there is a good opportunity set within the technology industry," argues Johansen, adding that "there is a lot of disruption and a lot of volatile share prices."

The disruption creates opportunities both on the long and short side. "If you adjust for the market, we have created alpha both in the long and short book. In fact, the stock picking in the short book has been somewhat better, and we have been showing that it is possible to deliver alpha on the short side."